

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:01

PLR-126840-10

Date:

August 06, 2010

Legend:

Distributing =

Controlled =

State X =

Shareholder 1 =

Shareholder 2 =

Beneficiary 1 =

Beneficiary 2 =

Beneficiary 3 =

Beneficiary 4 =

Business 1 =

Business 2 =

aa =

bb =

Date A =

Dear :

This letter is in response to your June 22, 2010 request for rulings regarding certain federal income tax consequences of a proposed transaction (the "Proposed Transaction"). The information submitted in that request and in your later correspondences is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has reviewed no information pertaining to, and has made no determination regarding, whether the Proposed Transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see section 355(e)(2)(A)(ii) and § 1.355-7).

### **Summary of Facts**

Distributing, a State X corporation, is treated as an S corporation for federal income tax purposes and is engaged directly in Business 1. Shareholder 1 and Shareholder 2 each own aa shares of Distributing common stock; no other classes of Distributing stock have been authorized. Shareholder 1 is a revocable trust whose beneficiaries are Beneficiary 1 and Beneficiary 2; Shareholder 2 is a revocable trust whose beneficiaries are Beneficiary 3 and Beneficiary 4 (together, the "Beneficiaries").

On Date A, Distributing contributed Business 2 to Controlled, a newly formed State X limited liability company that authorized and issued bb membership interests to

Distributing. Controlled is a qualified subchapter S subsidiary (“QSub”) for federal income tax purposes.

The financial information submitted by Distributing and Controlled indicates that Business 1 and Business 2 each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the last five years.

### **Proposed Transaction**

For what are represented to be valid business purposes, Distributing proposes to distribute all interests in Controlled to Shareholder 1 in exchange for all of Shareholder 1’s stock in Distributing (the “Distribution”).

### **Representations**

The taxpayers have made the following representations in connection with the Proposed Transaction:

- (a) The fair market value of Controlled interests and other consideration, if any, to be received by Shareholder 1 will be approximately equal to the fair market value of Distributing stock surrendered by Shareholder 1 in the exchange.
- (b) No part of the consideration to be distributed by Distributing in the Distribution will be received by Shareholder 1 as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted with regard to Business 1 and Business 2 is representative of each business's present operations and, with regard to each business, there have been no substantial operational changes since the date of the last financial statement submitted.
- (d) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.
- (e) Neither Business 1 nor Business 2 nor control of an entity conducting either business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part.
- (f) The Distribution is carried out for the corporate business purpose of resolving a disagreement between and among the Beneficiaries regarding the extent to which future operations should emphasize Business 1 or Business 2. The

Distribution is motivated, in whole or substantial part, by this corporate business purpose.

- (g) The proposed transaction will not be used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (h) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (i) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled interests entitled to vote, or 50 percent or more of the total value of all classes of Controlled interests, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (j) The Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of section 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (k) The total adjusted basis and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of (i) the total liabilities assumed (within the meaning of section 357(d)) by Controlled plus any liabilities to which the transferred assets were subject, and (ii) the total amount of any money and the fair market value of any other property (within the meaning of section 361(b)) received by Distributing and transferred to its creditors in connection with the reorganization.
- (l) The liabilities assumed (as determined under section 357(d)) by Controlled in the transaction and the liabilities to which the transferred assets were subject were incurred in the ordinary course of business and were associated with the assets being transferred.

- (m) The fair market value of the assets of Controlled exceeded the amount of its liabilities immediately after the exchange.
- (n) The aggregate fair market value of the assets transferred to Controlled in the transaction equaled or exceeded the aggregate adjusted basis of these assets.
- (o) Distributing has neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.
- (p) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
- (q) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (r) No two parties to the Proposed Transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
- (s) Immediately after the Distribution, neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of section 355(g)(2)).
- (t) Distributing is an S corporation and Controlled is a QSub (within the meaning of section 1361).
- (u) Immediately after the Distribution, Controlled will elect to be an S corporation pursuant to section 1362(a), effective immediately after the Distribution.
- (v) There is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.
- (w) None of the persons holding stock, membership interests, or any equity interest in either Distributing or Controlled is a non-resident alien individual, a foreign corporation, or a trust (except for trusts meeting the requirements of section 1361(c)(2)).

### **Rulings**

Based solely on the information submitted and the representations made, we rule as follows:

- (1) The Distribution will cause a termination of Controlled's election to be a QSub because Controlled will cease to be a wholly-owned subsidiary of an S corporation. For federal income tax purposes, the Distribution will be treated as if Controlled is a new

corporation acquiring all of its assets (and assuming all of its liabilities) in a deemed contribution (the "Contribution") from Distributing occurring immediately before the Distribution, and Distributing will be deemed to receive the membership interests in Controlled in exchange for the Contribution (§ 1.1361-5(b)(1)(i)).

(2) The Contribution followed by the Distribution will be a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" within the meaning of section 368(b).

(3) No gain or loss will be recognized by Distributing on the Contribution (sections 361(a) and 357(a)).

(4) No gain or loss will be recognized by Controlled on the Contribution (section 1032(a)).

(5) The basis of each asset deemed received by Controlled will be equal to the basis of such asset in the hands of Distributing immediately before its transfer (section 362(b)).

(6) The holding period for each asset deemed received by Controlled will include the period during which such asset was held by Distributing (section 1223(2)).

(7) No gain or loss will be recognized by Distributing on the Distribution (section 361(c)).

(8) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder 1 upon receipt of Controlled interests (section 355(a)(1)).

(9) The basis of the Controlled interests in the hands of Shareholder 1 after the Distribution will equal the basis of the Distributing stock surrendered in exchange therefor (section 358(a)(1)).

(10) The holding period of the Controlled interests received by Shareholder 1 in the Distribution will include the holding period of the Distributing stock with respect to which it is received, provided that the Distributing stock is held as a capital asset in the hands of Shareholder 1 on the date of the exchange (section 1223(1)).

(11) As provided in section 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a).

### **Caveats**

Except as expressly provided herein, no opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Code or regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction not specifically covered by the above rulings. In particular, no

opinion is expressed regarding: (i) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the Distribution is used principally as a device for the distribution of earnings and profits of Distributing and Controlled or both (see section 355(a)(1)(B) and § 1.355-2(d)); or (iii) whether the Distribution is part of a plan (or series of related transactions) under section 355(e)(2)(A)(ii). Additionally, no opinion is expressed regarding issues relating to Controlled's subchapter S election.

### **Procedural Statements**

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that this private letter ruling may not be used or cited as precedent.

A copy of this letter must be attached to the federal income tax returns to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching to the return a statement that provides the date and control number (PLR-126840-10) of this ruling letter.

Pursuant to the power of attorney on file in this matter, a copy of this letter is being sent to your authorized representative.

Sincerely,

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Mark J. Weiss  
Assistant to the Branch Chief, Branch 1  
Office of Associate Chief Counsel (Corporate)